COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER

KENNETH HAHN HALL OF ADMINISTRATION
500 WEST TEMPLE STREET, ROOM 525
LOS ANGELES, CALIFORNIA 90012-2706
PHONE: (213) 974-8301 FAX: (213) 626-5427

J. TYLER McCAULEY
AUDITOR-CONTROLLER

WENDY L. WATANABE
CHIEF DEPUTY

March 25, 2008

TO: Supervisor Yvonne B. Burke, Chair
Supervisor Gloria Molina
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM: J. Tyler McCauley
Auditor-Controller

SUBJECT: **FISCAL REVIEW OF THE SHERMAN GROUP, INCORPORATED - A GROUP HOME FOSTER CARE CONTRACTOR**

Attached is our audit report on the fiscal operations of The Sherman Group, Inc., (Sherman or Agency) from January 1, 2006 through December 31, 2006. Sherman is licensed to operate twelve group homes (GH), each with a resident capacity of six children. Ten of Sherman's twelve group homes provided services to Los Angeles County foster children. Sherman's Los Angeles County group homes are located in the Fifth Supervisorial District.

The Department of Children and Family Services (DCFS) contracts with Sherman to care for foster children placed in the Agency's homes. DCFS paid Sherman $5,613 a month per child, based on a rate determined by the California Department of Social Services. Sherman received a total of $2,623,911 from DCFS during 2006.

Scope

Our review was intended to determine whether Sherman complied with its contract terms and appropriately accounted for and spent foster care funds on allowable and reasonable expenditures. We also evaluated Sherman's expenditure and revenue documentation, internal controls and compliance with applicable federal, State and County fiscal guidelines governing GH funds.

Summary of Findings

We identified $33,321 in unallowable/inadequately supported costs, primarily from unallowable credit card purchases and fundraising expenditures. In addition, DCFS and the Agency need to work together to resolve potential overpayments.

Sherman also needs to develop a plan to allocate administrative costs to individual county programs, strengthen its internal controls over credit cards, cash disbursements, fixed assets, bank reconciliations, payroll/personnel procedures and contractor services. Details of our findings are discussed in the attached report.

DCFS needs to resolve the questioned costs and collect any disallowed amounts. In addition, DCFS needs to ensure that Sherman's management takes action to address the recommendations in this report and monitor to ensure that the actions result in permanent changes.

Review of Report

We discussed our report with Sherman's management on December 11, 2007. The Agency will provide their response to the report directly to DCFS. DCFS will incorporate the Agency's response into a Fiscal Corrective Action Plan that will be submitted directly to the Board of Supervisors. We thank Sherman's management and staff for their cooperation during our review.

Please call me if you have any questions, or your staff may contact Jim Schneiderman at (626) 293-1101.

JTM:MMO

Attachment

c: William T Fujioka, Chief Executive Officer
Patricia S. Ploehn, Director, Department of Children and Family Services
Susan Kerr, Chief Deputy Director, Department of Children and Family Services
Willie Sherman, Executive Director, The Sherman Group, Incorporated
Board of Directors, The Sherman Group, Incorporated
Cora Dixon, Bureau Chief, Foster Care Audits Bureau, California Department of Social Services
Sheliah Dupuy, Bureau Chief, Foster Care Rates Bureau, California Department of Social Services
Sachi Hamai, Board of Supervisors Executive Office
Public Information Office
Audit Committee Members
Commission for Children and Families

The Sherman Group, Incorporated
Fiscal Review – 1/1/2006 to 12/31/2006

REVIEW OF EXPENDITURES/REVENUES

We identified $30,038 in unallowable costs and $3,283 in unsupported/inadequately supported costs.

Applicable Regulations and Guidelines

Sherman is required to operate its GH in accordance with the following federal, State and County regulations and guidelines:

- GH Contract, including Exhibit C-2, Auditor-Controller Group Home Contract Accounting and Administration Handbook (A-C Handbook)
- Federal Office of Management and Budget Circular A-122, Cost Principles for Non-Profit Organizations (Circular)
- California Department of Social Services Manual of Policies and Procedures (CDSS-MPP)
- California Code of Regulations, Title 22 (Title 22)

Unallowable Costs

We identified $30,038 in unallowable group home expenditures:

- $11,549 in credit card expenses. The Agency charged $5,528 in personal expenses unrelated to the group home program, $3,093 in finance charges and $2,928 in late fees and over limit fees.
- $9,162 in other unallowable costs. The Agency included as group home expenditures $8,345 in interest, $756 in Non-Sufficient Funds (NSF) and overdraft fees, and $61 in finance charges and late payment fees.
- $45 in unnecessary expenses and late charges by vendors.

A-C Handbook Section C.1.5 states that only expenditures that are necessary, proper and reasonable to carry out the purposes and activities of the program are allowable. In addition, Circular Sections 16 and 23 state that penalties and interest are unallowable.

- $9,282 in fundraising costs paid to a contractor.

Circular Section 17 states that the costs of organized fundraising, including financial campaigns, solicitation of gifts/bequests and similar expenses incurred solely to raise capital or obtain contributions, are unallowable.

Inadequately Supported Costs

A-C Handbook Section A.3.2 states that all expenditures shall be supported by original vouchers, invoices, receipts or other supporting documents, and that unsupported expenditures will be disallowed upon audit.

We identified $3,283 in group home expenditures that were inadequately supported. Specifically:

- $2,632 in credit card charges. The Agency provided credit card statements and cancelled checks but did not provide original itemized receipts or an explanation of the expenses.

- $651 in payments for telephone and travel expenses. The Agency provided cancelled checks for these expenses but did not provide receipts or the receipts provided were not itemized. Without itemized receipts, we could not determine if these expenses were for the group home program.

Recommendations

1. **DCFS management resolve the $33,321 in questioned costs and collect any disallowed amounts.**

Sherman's management:

2. **Ensure that foster care funds are used for allowable expenditures to carry out the purpose and activities of the Agency.**

3. **Maintain adequate supporting documentation for all expenditures, including original itemized invoices and receipts.**

Potential DCFS Overpayments

DCFS records show overpayments made to the Agency. DCFS and the Agency should work together to resolve the overpayments and DCFS should collect any verified overpayments. Sherman's management should ensure that any future payment discrepancies are immediately reported to DCFS and any excess amounts are repaid promptly.

Recommendations

4. **DCFS management work with Sherman's management to resolve the differences in the overpayment balances and take steps to recover any verified overpayments.**

5. **Sherman's management ensure that future payment discrepancies are immediately reported to DCFS and excess amounts are repaid promptly.**

Interest Payments on 90th Street Property

Sherman is making monthly mortgage payments for a group home on 90th Street in Lancaster, California. The Agency purchased the property in February 2004. Circular Section 23 states that interest on debt incurred to acquire facilities over $500,000 is allowable if the organization prepares a lease/purchase analysis, before buying the facility, which shows that purchasing is less costly than leasing. Sherman's management indicated that it did not prepare a lease/purchase analysis on this property prior to the purchase. During our review period, Sherman paid $45,318 in interest on this property. Sherman's management should prepare a lease/purchase analysis on the property for DCFS' approval. If DCFS does not approve the analysis, the $45,318 in interest, as well as interest from prior years, should be disallowed.

Recommendations

6. **Sherman's management prepare a lease/purchase analysis on the 90th Street property in Lancaster for DCFS' approval.**

7. **DCFS management review the lease/purchase analysis and determine if the property is less costly to purchase than to lease. If purchasing is not less costly, the interest paid for the property is unallowable and should be recovered by DCFS.**

CONTRACT COMPLIANCE AND INTERNAL CONTROLS

We noted several contract compliance issues and internal control weaknesses. DCFS should ensure that Sherman's management takes action to address each of the recommendations in this report. DCFS should also monitor the Agency to ensure that these corrective actions result in permanent changes.

Allocation of Costs

Sherman provides group home services to five counties, in addition to Los Angeles County. A-C Handbook Section C.2.0 requires agencies to allocate costs that benefit multiple programs on an equitable basis. Sherman records all administrative costs at the Group Home program level and does not allocate these costs to the individual counties.

Sherman's management should develop a plan to allocate administrative costs to each county's program on an equitable basis.

Recommendation

8. **Sherman's management develop a plan to allocate administrative costs to each county's program on an equitable basis.**

Accounting and Disbursement Procedures

We noted the following weaknesses in the Agency's accounting and disbursement procedures:

- As previously discussed, Agency credit cards were used for personal expenses. A-C Handbook Section B.2.4 states that credit cards must be adequately protected and monitored to ensure that only authorized and necessary items are purchased. Sherman's management needs to develop a written policy requiring that Agency credit cards be used only for group home activities.

- The Agency issued 49 checks totaling $71,130, where the check signor and the payee were the same. When a check signor is also the payee, the Agency should require a second management level review of the expenditure and a second signature on the check to ensure that only authorized and necessary items are purchased.

- The Agency made ATM and cash withdrawals for amounts up to $3,114. Sherman staff indicated that these withdrawals were for payment of children's allowances, and for the purchase of food, clothing and program activities. The use of cash for children's allowances would be appropriate. However, purchases of food and clothing should be made using a more secure form of payment, such as an agency check, debit or credit card.

- As indicated above, the Agency periodically uses cash for items such as children's allowances. We noted that the Agency does not have an imprest petty cash fund for these types of small, incidental expenses. A-C Handbook Section B.2.3 states that a petty cash fund up to $500 may be maintained for small, incidental expenses.

- The Agency's fixed asset listing does not include the description and serial number of each asset. In addition, the Agency indicated that they did not conduct an annual inventory of their fixed assets. A-C Handbook Section B.4.2 states that contractors should maintain a current list of fixed assets with the item description, serial number, date of purchase, acquisition costs and source of funding. Contractors should also conduct an inventory of fixed assets at least once each year to ensure that all fixed assets are accounted for and in proper working order.

Recommendations

Sherman's management:

9. **Develop a written policy that Agency credit cards must be used only for group home activities.**

10. **Require a second management level review and second signature on the check, when a check signor is also the payee.**

11. **Establish a petty cash fund for small, incidental expenses.**

12. **Maintain a fixed asset listing that clearly identifies each item's description, serial number, date of purchase, acquisition cost and source of funding.**

13. **Conduct an inventory of fixed assets at least once each year to ensure that all fixed assets are accounted for and in proper working order.**

Bank Reconciliations

A-C Handbook Section 1.4 states that monthly bank reconciliations should be prepared within 30 days of the bank statement date and reviewed by management for appropriateness and accuracy. Both the preparer and the reviewer should sign and date the bank reconciliations. Timely bank reconciliations are necessary to verify the accuracy of the Agency's accounting records and bank balance, as well as to identify and investigate any checks that have not cleared the bank within a reasonable time period.

Eleven of 12 monthly bank reconciliations (92%) were not prepared within 30 days of the bank statement date. In addition, the preparer did not sign the bank reconciliation, and there is no indication that the Agency's management reviewed the reconciliations.

Recommendations

Sherman's management:

14. **Ensure bank reconciliations are prepared within 30 days of the bank statement date.**

15. **Ensure the Agency's bank reconciliations are signed and dated by both the preparer and reviewer, and reviewed by management for appropriateness and accuracy.**

Payroll/Personnel Controls

CDSS MPP Section 11-402 requires that supporting documentation be maintained for all program expenditures, including employee salary rates. In addition, A-C Handbook Section B.3.1 states that timecards must be prepared for each pay period, and be signed in ink by the employee and the employee's supervisor to certify the accuracy of the reported time.

We sampled the personnel files and payroll records of 12 employees and noted the following:

- Two salaried employees (17%) did not prepare timecards.
- One timecard (8%) did not have the employee's signature.
- One timecard (8%) did not have the supervisor's signature.
- Six personnel files (50%) did not contain the employee's current pay rate.

Recommendations

Sherman's management:

16. **Ensure all Agency employees prepare timecards for each pay period.**
17. **Ensure timecards are signed by the employee and their supervisor.**
18. **Ensure employee pay rates are consistently documented and updated in the employees' personnel files.**

Independent Contractors

A-C Handbook Section A.2.6 requires contractors to comply with federal and State requirements for reporting payments to contractors. In addition, A-C Handbook Section A.3.2 requires an agency to have a contract, time records, billing rates and invoices for contractors. We reviewed five independent contractors hired by the Agency and noted:

- Sherman did not report the income for four of the contractors to the taxing agencies.

- One independent contractor did not prepare invoices detailing actual work performed.

Recommendations

Sherman's management:

19. Ensure all payments to independent contractors are properly reported to the federal and State taxing agencies.

20. Ensure that invoices are maintained detailing the actual work performed by contractors.

Non-Compliance with Insurance Requirements

A-C Handbook Section F.1.0 states that an agency must have insurance coverage required by the contract, with an endorsement naming the County as additional insured. Sherman's workers' compensation insurance did not name the County as an additional insured.

Recommendation

21. Sherman's management include the County as an additional insured on their workers' compensation insurance.